

CITY AUDITOR'S OFFICE



AUDIT OF SPECIAL IMPROVEMENT DISTRICT ADMINISTRATION

Report No. CAO 602-0203-04

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CITY AUDITOR

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BACKGROUND

Special Improvement Districts (SID) are created to fund public improvements such as utilities, roads, and sidewalks within each district. The improvements are usually financed by 20-year municipal bonds. Each parcel in a SID is levied a special assessment and the property owners are responsible for paying the City semi-annual installments to service the related debt. A SID can be initiated at the request of a developer, a property owner, or the City. In 2002, the City had approximately 20,000 parcels with a total improvement assessment value of over \$180 million as shown in the following table.

SID District	Year SID Created	Number of Parcels	SID Assessment
Summerlin 404	1989	10,651	\$ 73.9 million
Elkhorn Springs 505	1993	2,146	9.5 million
Summerlin 707	1996	4,978	40.0 million
Summerlin 808	2001	961	46.0 million
Non-Developer (36 districts)	Varied	939	10.8 million
Total for all Districts (as of 9/20/2002)		19,675	\$180.2 million

Chapter 271 of the Nevada Revised Statutes (NRS) outlines the rules and regulations for SID. Currently, the City Treasurer's Office oversees all financial matters related to SID including issuance of bonds, billing and collection of semi-annual payments, and debt servicing. The City has outsourced its SID billing and collection function to a contractor since 1994.

OBJECTIVES

The objectives of our audit were to determine whether:

- The City Treasurer's Office is fulfilling its fiduciary responsibilities in administering the special improvement districts; and
- The City is in compliance with NRS 271.

SCOPE AND METHODOLOGY

We performed the audit in accordance with generally accepted governmental auditing standards. Our audit procedures included:

- Reviewing NRS 271 regarding special/local improvements;
- Benchmarking the City's processes with other local governments in Nevada;
- Interviewing management and staff involved in the administration of SID;
- Assessing the adequacy of the City's financial reporting for SID;
- Reviewing service agreements between the City and the contractor;
- Examining the bond issuance, refinancing, and refunding/retirement documents;
- Analyzing billing and payment transactions; and
- Reviewing administrative processes related to delinquent payments.

FINDINGS AND RECOMMENDATIONS

The City Auditor's Office appreciates the courtesy and cooperation extended to us by the Treasurer's Office and the contractor during the audit. Our audit identified issues management should address to improve controls over the administration of the City's Special Improvement Districts. These issues are summarized in the following sections. While other issues were identified and discussed with management, they were deemed less significant for reporting purposes.

1. BILLING SERVICE CONTRACT

Criteria:

- Adequate controls should exist to ensure outsourced services are properly acquired and closely monitored.

Condition:

- The Treasurer's Office was responsible for the semi-annual SID billings in the early 1990s when there were fewer than two thousand SID parcels in the City. Since 1994, the City's SID billing function has been outsourced to the current billing service contractor.
- In April 1994, the City's Financial Advisor created a billing company, which subsequently became the City's SID billing contractor.

- According to the September 7, 1994 City Council Agenda, “Finance provided a Request For Proposal (RFP) to four firms and, upon evaluation of responses, selected the current contractor.”
- When we requested to review the RFP documentation, management was not able to provide evidence to indicate whether the RFP was indeed sent to other firms besides the current contractor.
- Our review of the billing service contract and its surrounding controls indicated the following deficiencies:
 - Purchasing and Contract staff were not involved in the RFP or periodic contractor evaluation processes;
 - Information Technologies staff were not involved in determining the IT requirements to ensure proper planning for disaster recovery and business resumption;
 - Lack of documentation on how the service fees and their subsequent changes (e.g. \$26 for mailing a delinquent notice) were evaluated to ensure they are competitively priced;
 - Contractor’s roles and responsibilities (e.g. record retention, reporting requirements) were not clearly defined; and
 - Lack of performance standards and penalties for not meeting the required standards.

Cause:

- Inadequate controls for outsourced services.

Effect:

- Potential for disputes with the billing service contractor.
- The City may not be getting best value for services or costs may be excessive.

Recommendation:

1. The City Treasurer’s Office, in conjunction with Purchasing and Information Technologies, should reevaluate and amend the current SID billing service contract.
2. The Finance and Business Services Director should request that Purchasing and the City Treasurer’s Office periodically prepare a new RFP for the SID billing services.
3. Purchasing and Contract should maintain all RFP documents related to the SID billing service contract.

2. OVERSIGHT AND COORDINATION RESPONSIBILITIES

Criteria:

- An organization must establish adequate controls to fulfill its responsibilities.

Condition:

- The City assumes various fiduciary responsibilities (e.g. billing, collection, record keeping) in administering the SID and the related long-term debts.
- Several city departments/divisions are involved in SID including Public Works, Treasury, Purchasing, City Attorney, and City Clerk. While their roles are apparent, their responsibilities regarding SID have not been clearly defined. We encountered various situations that indicate a need for improved coordination and assignment of SID responsibilities.
- Our review of financial controls related to SID indicates the following weaknesses:
 - The Treasurer's Office processes the contractor's invoices without requesting supporting information or verifying their accuracy (e.g. monthly invoices are paid based on a Treasury staff's assessment of reasonableness instead of confirming the actual tasks performed by the contractor).
 - The Treasurer's Office does not conduct periodic independent verification to ensure the contractor bills all SID parcels accurately and in a timely manner.

Cause:

- Inadequate oversight and coordination of SID activities.

Effect:

- Potential for undetected billing errors and payment for services not provided.
- City could encounter legal and financial liabilities if the Treasurer's Office failed to collect sufficient funds from the property owners to service the long-term debts.

Recommendation:

1. The City Manager's Office should clearly define the roles and responsibilities of the city departments/divisions involved in the administration of SID.
2. The Treasurer's Office should properly verify the contractor's invoices before payments.
3. The Treasurer's Office should establish procedures and perform periodic review of the accuracy and completeness of SID billings.

3. ACCOUNTING FOR ADMINISTRATIVE COSTS

Criteria:

- SID administrative costs should be properly accounted for and matched against the related administrative fees.

Condition:

- According to NRS, the City can charge the SID property owners an administrative fee up to 1% higher than the bond interest.
- Late payment penalties collected are also SID administrative fees.
- These administrative fees and the related expenditures are accounted for in the City's SID Administration Special Revenue Fund which had a fund balance of approximately \$5 million as of June 30, 2002.
- Currently, the labor costs charged against SID are not all directly related to the administration of SID. For example, the total salaries and benefits of two city employees who spend minimal to no time on SID are being charged against the SID Administration Special Revenue Fund.
- On the other hand, certain related costs are not being charged against the fund. For example, the labor costs of a Treasury employee who spends approximately half of her time on SID administration and those of the City Treasurer are not being charged against SID.

Cause:

- Incorrect accounting for and inadequate monitoring of SID administrative costs.

Effect:

- Inappropriate labor costs are being charged against SID administrative fees collected.
- Certain labor costs are not appropriately being charged against SID administrative fees collected.

Recommendation:

1. The City Treasurer's Office, in conjunction with the Budget Division, should establish a system by which SID administrative labor costs are properly accumulated and charged against SID administrative fees.

4. POLICIES AND PROCEDURES

Criteria:

- Documented policies and procedures help ensure consistency in practices and compliance with laws and regulations.

Condition:

- NRS 271 contains certain provisions for SID including guidance on issuance of bond, interest rates, and late payment penalties. In addition, the SID assessment ordinances and bond ordinances also stipulate financial terms for the property owners. While some of these regulations are specific, others are not clearly defined.
- Over the past nine years, the Treasurer's Office, in conjunction with the bond counsel and the billing contractor, have developed various policies and procedures in handling SID billing and collection. However, many of the current practices have not been formally documented or defined. Examples of these areas include:
 - Late payment penalty waiver policies are not clearly defined;
 - Foreclosure sale procedures are not clearly documented; and
 - Post redemption period transaction guidelines are not formalized.
- While a mutual understanding of the division of responsibilities between the billing contractor and the Treasurer's Office exists, these responsibilities are not sufficiently documented.
- The Treasurer's Office, the billing contractor, and the City Attorney's Office all retain various SID documents and files. However, no guidelines exist as to the responsibilities for document retention.

Cause:

- City's long-term working relationship with the billing contractor.

Effect:

- Potential for misunderstandings as to areas of responsibility and accountability.

Recommendation:

1. The City Treasurer's Office should create formal SID policies and procedures, especially addressing issues not clearly specified in NRS or the assessment and bond ordinances.
2. The City Treasurer's Office, in conjunction with the City Clerk's Office, should establish guidelines for SID related document retention.

5. DELINQUENT BILLING NOTIFICATION

Criteria:

- Delinquent accounts should be billed and late penalties assessed on a timely basis.

Condition:

- If SID property owners fail to pay their semi-annual installments by the stipulated due dates, they receive monthly notices of the delinquent payments and the imposed late penalties.
- The billing contractor sends first delinquent payment notices to property owners after the due date but before the end of the grace period.
- Prior to the end of the grace period, payments are received for approximately one-third of these delinquent accounts.
- Late penalties initially posted to these accounts are subsequently waived.
- These waivers are known as auto-waivers.

Cause:

- The Treasurer's Office supports sending out delinquent billing notifications within the grace period in an effort to provide good customer service to property owners.

Effect:

- Unnecessary mailing of delinquent payment notices and subsequent waiving of the late penalties posted.

Recommendation:

1. The City Treasurer's Office should consider directing the SID billing contractor to delay mailing first delinquent notices until after the end of the respective grace periods.

6. FEE WAIVERS

Criteria:

- Waivers of fees should be properly documented, authorized, and monitored.

Condition:

- The Treasurer's Office has not established formal policies and procedures for waiving SID related fees. The Office has not specified what documentation is required for fee waivers.
- Waiver authorities for SID related fees have not been formally defined.
- No guidelines exist for handling waivers for related parties in which there could be the appearance of preferential treatment.
- Our review of 145 manual waivers processed in 2002 identified inconsistent practices in the handling of fee waivers including:
 - Some fees were waived by the contractor after obtaining written approval from the City while other fees were waived without obtaining written approval.
 - Some one-time fee waivers included waivers of multiple late penalties while others only included waivers of a single late penalty.
 - Certain descriptions of waivers on the billing system did not adequately justify waiver.

Cause:

- Management has not formalized policies and procedures relating to the waiving of fees.

Effect:

- Inadequate authorization and justification for waiving fees.

Recommendation:

1. The City Treasurer's Office should develop written SID policies and procedures addressing fee waivers. The policies and procedures should address SID fee waiver authority, supporting waiver documentation requirements, and handling of waivers with related parties.

7. FORECLOSURE SALES

Criteria:

- Policies and procedures related to foreclosure sales should be formally documented to ensure consistency in practice and compliance with laws and regulations.

Condition:

- If a property owner fails to bring all delinquent SID installments current within 60 days, the City will conduct a foreclosure sale of the delinquent property for the total amount due and issue a certificate of sale to the purchaser.
- NRS does not specifically address certain aspects of the foreclosure sale. For example, it does not address how to handle the situation when multiple persons are interested in a single property.
- Over the years, the City has developed a process by which certificates of sale are sold. This process includes the selection of a “winner” and two alternates from all interested parties through a random number generator program. However, no documentation exists justifying how the City’s foreclosure sale process is in compliance with NRS.
- NRS states that payment for a certificate of sale must be made to the municipal treasurer before 10 a.m. of the day following the sale. However, during the July 2002 sale, the City allowed payment to be made until 2 p.m. the day following the sale.
- The Treasurer’s Office has accepted assignments of certificates of sale. However, documented guidelines for assignments have not been developed.

Cause:

- Lack of formal operational policies and procedures.

Effect:

- Inconsistent practices.
- Non-compliance with NRS.

Recommendation:

1. The City Treasurer’s Office should seek legal opinion on the City’s application of NRS for foreclosure sales and then establish formal policies and procedures for foreclosure sales.

2. The City Treasurer's Office should ensure payments for certificates of sale are made by 10 a.m. the day following the foreclosure sale.
3. The City Treasurer's Office should establish formal guidelines for assignments of certificates of sale for reference by city staff and the public.

8. CERTIFICATE REDEMPTION

Criteria:

- Certificate redemption policy and procedures should be formally documented to ensure consistent practices.

Condition:

- According to NRS, any certificate of sale for a delinquent property is subject to redemption by the property owner within two years. The redemption period is shortened to 120 days if there is no significant permanent improvement on the property.
- NRS is unclear as to whether a property owner can redeem certificates beyond the stipulated redemption periods.
- Our review of SID redemptions identified redemptions by property owners beyond the stipulated redemption periods.

Cause:

- Lack of formalized policy and guidelines by the City on acceptability of redemptions beyond redemption periods.

Effect:

- Potential for noncompliance with NRS.

Recommendation:

1. The City Treasurer's Office should seek a legal opinion with regard to redemptions beyond the redemption period to ensure the City is in compliance with NRS. Policy and procedures on this issue should be established.

9. ACCOUNT RECONCILIATIONS

Criteria:

- Monthly reconciliation of accounts can help identify errors or irregularities in a timely manner.

Condition:

Deposit Account Reconciliation

- The Customer Deposit Account into which SID deposits are initially recorded prior to being recorded to the SID Trust Accounts had never been reconciled prior to the end of fiscal year 2002.
- An incident occurred in 2000 where a refund was significantly delayed. Such an incident could have been avoided if the Customer Deposit Account was regularly reconciled.
- The Treasurer's Office stated that monthly reconciliation of the Customer Deposit Account would be performed on a quarterly basis following the end of the first quarter of fiscal year 2003.
- Monthly reconciliation between SID deposits per the bank, the billing contractor, and the general ledger are currently completed on a quarterly basis.

Investment Account Reconciliation

- SID investment accounts are reconciled monthly by the same individual responsible for city investments.
- There is no evidence of supervisory review of the reconciliations.
- Only the most recent SID investment account reconciliation completed is maintained by the Treasurer's Office.

Cause:

- Lack of monitoring of account reconciliations.

Effect:

- Potential for untimely identification of errors or unallocated funds.

Recommendation:

1. The City Treasurer's Office should reconcile the Customer Deposit Account on a monthly basis and follow-up on any significant or unusual differences.
2. The City Treasurer's Office should complete the reconciliation between SID deposits per the bank, the billing contractor, and the general ledger on a monthly basis.
3. The City Treasurer's Office should at a minimum maintain SID investment account reconciliations for the current and preceding fiscal year.
4. The City Treasurer should complete a supervisory review of SID related reconciliation completed by his Office.

10. CONTINGENCY PLANNING

Criteria:

- Contingency planning allow for normal processes to continue when unexpected changes occur in the operating environment.

Condition:

- The billing contractor maintains the SID billing data in its proprietary billing system and generates periodic operating reports for the City.
- Staff from both the billing contractor and the City Treasurer's Office are responsible for processing and managing the SID billing information.
- The City Treasurer's Office has not established an SID processing contingency plan to respond to the following "disasters":
 - Unplanned personnel changes;
 - System breakdown;
 - Loss of data or records;
 - Unavailability of billing data;

Cause:

- Establishment of contingency plan has not been a priority for management.

Effect:

- Potential loss of billing data.
- Potential inability to provide current information to SID property owners.

Recommendation:

1. The City Treasurer's Office should develop an SID processing contingency plan.

11. REPORTING OF INTEREST PAID

Criteria:

- The City should comply with IRS filing requirements.

Condition:

- Each year, the City sends tax letters to SID property owners informing them of the amount of interest paid to the City during the year when it exceeds six hundred dollars.
- Other local governments in Nevada use the IRS Form 1098 to convey the interest payment information to their SID property owners.

Cause:

- According to the Treasurer's Office, the City's bond counsel suggested using the tax letter in lieu of the IRS Form 1098.

Effect:

- The City may not be appropriately informing SID property owners of the amount of interest paid during the year.

Recommendation:

1. The City Treasurer's Office should obtain an official IRS determination of the proper method by which to report the interest paid by SID property owners.

MANAGEMENT RESPONSES

1. BILLING SERVICE CONTRACT

RECOMMENDATION 1

Management Plan of Action:

We concur.

Timetable:

We intend to issue a request for proposal (RFP) for this professional service contract by September 30, 2003.

RECOMMENDATION 2

Management Plan of Action:

We concur.

Timetable:

Starting with the new RFP, future contracts will be issued in two to five year increments.

RECOMMENDATION 3

Management Plan of Action:

Under current policy, the Purchasing and Contracts Division administers and executes the RFP process. Consequently, they will be responsible for maintaining all related documents.

Timetable:

Already implemented.

2. OVERSIGHT AND COORDINATION RESPONSIBILITIES

RECOMMENDATION 1

Management Plan of Action:

We agree with the Auditor's recommendation and have taken initial steps towards implementation. The rapid growth over the last ten years in special improvement districts, particularly developer SID's, is unprecedented. This growth has presented a challenge to the City to meet the staffing and infrastructure needs. The innovative use of contractual services in the administration of billing and receipting processes has been very successful and has allowed the City to fulfill its legal and fiscal responsibilities without hiring additional staff. An enhanced definition of roles and responsibilities will help bolster this success.

RECOMMENDATION 2

Management Plan of Action:

Treasury will perform periodic detailed reviews of the contractor's invoices. We will continue to review them on a regular basis for reasonableness, as this method has proven successful in the past in terms of the discovery of billing issues or problems.

Timetable:

Periodic detailed review will be performed when the Treasurer's Office has proper staffing to take on this additional work. We have asked for an additional staff position in the fiscal year (FY) 2004 budget request, and this task is contingent upon receiving that additional position.

RECOMMENDATION 3

Management Plan of Action:

As indicated in the response to Recommendation 2, we will perform the periodic reviews once the Treasury Division has sufficient resources to perform this type of review, we will begin to perform them.

Timetable:

Periodic review of the contractor's invoices will be performed when the Treasurer's Office has proper staffing to take on this additional work. We have asked for an additional staff position in the FY 2004 budget request.

3. ACCOUNTING FOR ADMINISTRATIVE COSTS

RECOMMENDATION 1

Management Plan of Action:

We concur.

Timetable:

This will be coordinated and implemented with the FY 2004 budget year.

4. POLICIES AND PROCEDURES

RECOMMENDATION 1

Management Plan of Action:

We concur. We have drafted an outline of the policies and procedures and we are in the process of seeking comments on the structure of the document.

Timetable:

We expect to have the policies and procedures complete by September 30, 2003.

RECOMMENDATION 2

Management Plan of Action:

We concur.

Timetable:

We expect to have a retention policy, coordinated with the City Clerk's office by September 30, 2003.

5. DELINQUENT BILLING NOTIFICATION

RECOMMENDATION 1

Management Plan of Action:

We strongly disagree with this recommendation. We feel we are best fulfilling our fiduciary responsibilities (to both the bond holders and the property owners) by giving the property owners advance notice of their late penalty. We believe the severity of the late penalties warrant the extra notice. Additionally, the sooner the property owners get their assessments in to us, the better the position we are in to pay debt service. This is particularly true in district 404, where debt service is due only 30 days after the assessment due date.

There is no need or apparent benefit to maximizing our late penalty revenues. Our administrative revenues and late penalty revenues are sufficient to cover the administrative costs associated with the SID billing and collection activities. This money cannot be used for any purpose other than to administer the respective SID districts. It cannot be used to augment the City's general fund. Whatever is left at the end of the assessment period must be refunded back to the property owners.

Timetable:

N/A

6. FEE WAIVERS

RECOMMENDATION 1

Management Plan of Action:

We concur.

Timetable:

We expect to have the policies and procedures complete by September 30, 2003.

7. FORECLOSURE SALES

RECOMMENDATION 1

Management Plan of Action:

The written policies and procedures will encompass the foreclosure sale process. We do not believe that a formal legal opinion is needed on our application of NRS, but we will have our outside counsel review the policies and procedures for compliance.

Timetable:

We expect to have the policies and procedures complete by September 30, 2003.

RECOMMENDATION 2

Management Plan of Action:

This was a one-time incident, and corrective action has been taken to prevent its recurrence.

Timetable:

This has already been corrected.

RECOMMENDATION 3

Management Plan of Action:

We no longer accept Assignment of Certificates of Sale, and this policy will be covered in our written policies and procedures. .

Timetable:

Although the policy has been implemented, we expect to have the policies and procedures complete by September 30, 2003.

8. CERTIFICATE REDEMPTION

RECOMMENDATION 1

Management Plan of Action:

The NRS does not prohibit redemptions after the stipulated period. Further, management strongly believes that it is in everyone's best interest to allow for redemption after the stipulated period for a variety of reasons, most significantly having to do with the certificate holder's lack of proper notice to the homeowner. This issue will be covered in our written policies and procedures.

Timetable:

We expect to have the policies and procedures complete by September 30, 2003.

9. ACCOUNT RECONCILIATIONS

RECOMMENDATION 1

Management Plan of Action:

We concur. However, until we have adequate staffing to perform this work, we will be unable to keep these reconciliations current.

Timetable:

We have asked for an additional staff position in the FY 2004 budget request.

RECOMMENDATION 2

Management Plan of Action:

We concur. However, until we have adequate staffing to perform this work, we will be unable to keep these reconciliations current.

Timetable:

We have asked for an additional staff position in the FY 2004 budget request.

RECOMMENDATION 3

Management Plan of Action:

Effective October 2002, all back-up documentation is retained.

Timetable:

This has already been resolved.

RECOMMENDATION 4

Management Plan of Action:

Effective October 2002, the City Treasurer reviews the monthly investment reconciliation completed by the Treasurer's Office staff. This is pursuant to the City Auditor's Office audit of City of Las Vegas Investments.

Timetable:

This has already been resolved.

10. CONTINGENCY PLANNING

RECOMMENDATION 1

Management Plan of Action:

We concur.

Timetable:

September 30, 2003

11. REPORTING OF INTEREST PAID

RECOMMENDATION 1

Management Plan of Action:

We have decided to start using the IRS Form 1098 to report interest paid to all property owners.

Timetable:

We will have this in place for the 2003 year-end reporting requirements (January 31, 2004).